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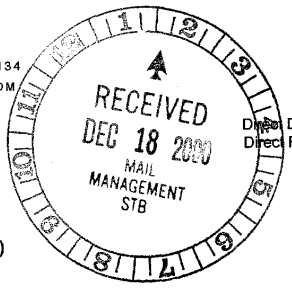

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December 18, 2000

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, NW, Suite 715
Washington, DC 20423-0001

Re: Ex Parte No. 582 (Sub-No. 1)
Major Rail Consolidation Procedures -- Notice of Proposed Rulemaking --
Comments of The Kansas City Southern Railway Company

Dear Secretary Williams:

Enclosed for filing are the original and twenty-five copies of the Reply Comments of The Kansas City Southern Railway Company on the Notice of Proposed Rulemaking issued by the Surface Transportation Board in *Major Rail Consolidation Procedures*, Ex Parte 582 (Sub-No. 1). Also enclosed is a 3.5 inch diskette formatted for Word Perfect containing a copy of this filing.

Please time and date stamp the extra copy of the Comments and return it with our messenger.

Please feel free to contact me if you have any questions.

Very truly yours,

William A. Mullins/TJH

William A. Mullins

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BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

NOTICE OF PROPOSED RULEMAKING

REPLY COMMENTS OF THE KANSAS CITY SOUTHERN RAILWAY COMPANY

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December 18, 2000

BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

NOTICE OF PROPOSED RULEMAKING

REPLY COMMENTS OF THE KANSAS CITY SOUTHERN RAILWAY COMPANY

Introduction

The Kansas City Southern Railway Company ("KCS"), by its counsel, hereby provides the Surface Transportation Board ("STB" or the "Board") with its Reply Comments on the Notice of Proposed Rulemaking ("*NPR*"), served October 3, 2000, in *Major Rail Consolidation Procedures*, Ex Parte No. 582 (Sub-No. 1).[1] In these Reply Comments, KCS will demonstrate that through the implementation of seven modest modifications to the regulations put forth in the *NPR*, the Board can achieve a middle ground between those who would reregulate the rail industry and those who recommend few substantial changes to the current regulations.

On November 17, 2000, nearly eighty parties filed comments with the Board in response to the *NPR*. The commentors represent the spectrum of parties holding legitimate interests in

[1] In response to the *NPR*, KCS previously filed Comments with the Board on November 17, 2000.

railroad mergers. Most of these parties have been deeply impacted by the fallout from the major recent rail mergers. Unfortunately, not a great deal of consensus emerges from a review of those comments. While some parties feared that the Board's proposed rules would lead to an overabundance of competition,[2] others felt that they did not go nearly far enough to preserve and enhance the competitive environment in which large railroads operate.[3] Some parties felt that the Board should focus on intramodal competition,[4] while others directed the Board's attention towards the importance of intermodal competition.[5] There was not even general agreement on whether the Board's existing environmental review process should be expedited[6] or expanded.[7]

After reviewing all of these comments, KCS has identified four general principles that it believes represent a fair consensus of the commenting parties:

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[2] *Comments of the Burlington Northern and Santa Fe Railway Company*, dated November 17, 2000, (Verified Statement of Richard J. Pierce, Jr.), at 17; *Opening Comments of CSX Corporation and CSX Transportation, Inc.*, dated November 17, 2000, at 35-50.

[3] *Consumers Untied for Rail Equity*, dated November 15, 2000, at 4-10; *Martin Marietta Materials, Inc.*, dated November 17, 2000 at 3-4.

[4] *Comments to the Surface Transportation Board of Canadian Pulp and Paper Association*, dated November 15, 2000, at 2-3; *Comments of the Committee to Improve American Coal Transportation on Proposed Rules*, dated November 17, 2000, at 4.

[5] *Comments of the Ohio Rail Development Commission in Ex Parte 582 (Sub-No. 1)*, dated November 17, 2000 at 9.

[6] *Comments of Norfolk Southern in Response to Notice of Proposed Rulemaking*, dated November 17, 2000, at 53-57; *Comments of the Committee to Improve American Coal Transportation on Proposed Rules*, dated November 17, 2000, at 27

[7] *Comments of the Ohio Rail Development Commission (Sub-No. 1)*, dated November 17, 2000 at 5-6; *Comments of the City of Mankato, MN*, dated November 17, 2000, at 4-8.

I. The merger rules must preserve competition.

Among the most notable features of the *NPR* was the Board's decision to place a premium on the enhancement of competition in all future mergers. Indeed, the *NPR* suggests that the enhancement of competition will be a necessary prerequisite to all future merger approvals. *See proposed* 49C.F.R. § 1180.1(c). As the Board undoubtedly anticipated, that proposal has generated a great many comments and critiques. KCS fears that lost in the smoke of the battle over enhanced competition has been the level of agreement over the Board's repeated emphasis on preserving existing levels of competition. In light of the great reduction in the number of independent railroads serving virtually all major terminal areas in the past twenty years, the majority of commentors in this proceeding have taken positions either explicitly or implicitly holding that no future merger may be approved if it has the effect of reducing competitive options. Even KCS's Class I brethren, while generally favoring a balancing test to weigh alleged merger benefits against anticipated harms, have been careful not to suggest that future merger review should discount the importance of preserving competition. Given this broad consensus, any final merger rules must safeguard the surviving competitive rail options vital to most shippers.

II. The merger rules must be made more specific.

Fully two-thirds of all commentors specifically stated that the proposed rules, as set forth in the *NPR*, do not provide adequate guidance to large railroads seeking to complete and submit a merger application, and/or they do not provide an adequate framework for parties concerned with various aspects of a proposed merger to either negotiate a resolution or urge conditions to remediate anticipated merger harms. If the final rules do not contain the level of specificity sought by the commentors, KCS believes that future merger proceedings will be marred by

wasted resources, unnecessary confusion, and a lack of clear direction and focus. In order to avoid the unfortunate consequences of indeterminate guidelines, KCS believes that the Board must make every effort in the final rules to provide clear guidance as to the Board's expectations for a proper major merger application.

III. The merger rules must provide closer scrutiny of claimed benefits.

In prior mergers, merger applicants have held relatively free sway over the nature of the benefits they would claim to emanate from their proposed combination and, importantly, the means by which they quantified and catalogued those benefits in their merger application. Without set guidelines or specific standards for the presentation of benefits, merger applicants have drafted their applications with an eye more directed toward merger approval than communicating all aspects of the impending transaction, and the Board has often given applicants the benefit of the doubt as to their ability to succeed on their merger plan. KCS is unaware of any parties to this proceeding taking the position that the Board should pay less attention to the claimed benefits of a proposed merger. In fact, while some parties have expressed reservations about the ability of applicants to quantify their anticipated benefits in the format proposed by the Board, no party has disagreed that significant enhancements need to be made in the Board's ability to assess the merits of alleged merger benefits. Accordingly, any new merger rules adopted out of this proceeding must improve both the provision of relevant information to the Board and the Board's ability to turn a critical eye on that information.

IV. The merger rules must protect shortline and regional railroad interests.

As a raft of parties have made clear in this proceeding, shortline and regional railroads are the lifeblood for a host of small communities and shippers across the nation. Despite facing very significant obstacles to success (including operating and marketing restrictions, old physical plant

in most cases, difficult financing, and occasional indifference from Class I connections), smaller railroads find ways to thrive in markets less important to larger railroads. Shortlines and regional railroads, like many shippers, are occasionally caught in the fallout of failed merger planning, and are often left without meaningful recourse when their service deteriorates due to faulty Class I connections. These concerns have spurred a very significant number of parties to urge the Board to take greater measure of the fate of smaller railroads when reviewing major merger applications. Any new merger regulations must, thus, further the interests of shortline and regional railroads, to assure that they remain a viable competitive element of the transportation network.

* * * * *

These four principles represent the collective vision of the parties participating in this proceeding. The principles should be viewed as a minimum, or baseline, against which all merger regulations must be measured, and against which all merger applications must ultimately be measured. Given the large number of parties that have participated in all phases of this proceeding, it can safely be said that these principles speak not to the aggrandizement of special interests, but to the interests of the railroad industry as a whole. Compliance with these principles will go a long way toward improving the overall satisfaction of all parties (large and small railroads, shippers, labor, ports and governmental interests) with the merger review process.

In light of the need for a change in direction, and in furtherance of the four principles distilled above, KCS has reviewed the Board's *NPR* and has concluded that overall, the new rules will improve the utility of Class I rail service for shippers and smaller railroads while simultaneously maximizing shareholder value. However, in several instances, the rules seem to

conflict with one or more of these four basic principles, or stop short of maximizing their potential utility to all interested parties. Therefore, in these Reply Comments, KCS reemphasizes the seven modest proposals for changes to the proposed regulations set forth in its previous Comments.[8] These suggested changes each foster realization of the aforesaid four principles. Many commentors in this proceeding have specifically endorsed KCS's proposals, or have urged the Board to adopt changes to the current regulations that are entirely consistent with KCS's proposed changes.

The seven proposals suggested by KCS would further the Board's goals of preserving and enhancing competition. They would also add greater specificity to the merger rules, ensure that existing competitive options are preserved, allow for greater scrutiny of alleged merger benefits, and enhance the role of shortline and regional railroads.

I. Rail Service Options Should Be Preserved In Merger Proceedings.

Although in several instances the *NPR* reflects a heightened concern with the preservation and enhancement of competition, it does not specifically set forth a requirement endorsed by numerous parties; that the Board should not approve a merger unless all existing[9] rail options are preserved. Merger applicants should be charged with the responsibility of providing viable alternative rail service for any shippers losing such service in a merger. In this manner, the Board should do more than merely preserve competition at 2-to-1 points, as it has traditionally done. Instead, all competitive rail options should continue to exist in a post-merger environment.

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[8] *Comments of the Kansas City Southern Railway Company*, dated May 16, 2000.

[9] See Section V of these Reply Comment for further particulars.

In some measure, language in the Board's *NPR* supports the importance of the preservation of rail competition. In particular, the Board's General Policy Statement (proposed Section 1180.1(a)) reflects that "the Board does not favor consolidations that reduce the railroad and other transportation alternatives available to shippers unless there are substantial and demonstrable public benefits to the transaction that cannot otherwise be achieved." The Board's chosen language closely tracks that proposed by KCS in its May 16, 2000 Comments on the *ANPR*.[10] As a point of clarity, however, KCS urges the Board to indicate that it intends to use its full conditioning authority to assure that rail options are preserved, and only then, if the "public benefits...cannot otherwise be achieved" without reducing competitive options, will the Board allow the number of rail carriers in any market to decrease. This addition is needed because, as drafted by the Board, Section 1180.1(a) implies that competition may be reduced if the benefits of the transaction as proposed by the applicants outweigh any unremediated competitive harms. However, before the Board should allow any competitive options to be reduced to achieve the so-called "benefits" of a merger, it should first explore all practical means of preserving competition through full use of its conditioning authority. Only then, after the Board has exhausted its conditioning authority and there remain benefits that cannot otherwise be achieved

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10 "It is in the public interest to preserve the number of independent rail carriers serving any terminal facility, station, or origin/destination corridor. Accordingly, any major rail merger application shall include a detailed plan to ensure that there is no reduction in the number of independent carriers serving any terminal facility, station, or origin/destination corridor or set forth facts showing that there is a substantial public interest justification for reducing the number of independent carriers. To the extent the application does not include such a detailed plan and unless there are substantial public interest justifications for not doing so, the Board will, upon request, impose conditions to preserve the number of independent carriers serving such a terminal, facility, station, or origin/destination corridor."

KCS Comments On ANPR, at 12-13.

without a reduction in competitive rail options, should competition be allowed to suffer as a result of a merger.

This proposed clarification could be inserted into the Board's proposed rule if the quoted language from the *NPR* were revised to read that "the Board does not favor consolidations that reduce the railroad and other transportation alternatives available to shippers unless there are substantial and demonstrable public benefits to the transaction that, even after exercise of the Board's full conditioning authority, cannot otherwise be achieved." Such a change would be consistent with the Board's intent, and would add greater precision to the regulations.

Another change to the policy statement might also be needed to fully protect rail options. At several points in the policy statement, the Board references other modes of transportation, and the impact that a major railroad merger might have on those modes. While KCS agrees that a rail merger might well have impacts on other transportation alternatives (hopefully presenting them with a stronger rail competitor), the Board's focus should be on preserving and enhancing competitive rail options as a remedy to specific competitive harms in a proposed merger. Instead, the Board's policy statement on the merger of Class I railroads says that the Board "welcomes private sector initiatives that enhance the capabilities and the competitiveness of the nations transportation infrastructure [including the nation's highways, waterways, ports and airports]." While intermodal competition can be a factor in assessing the competitive impacts of a merger, the Board should place its predominant focus on preserving the pre-merger level of rail-to-rail competition at locations adversely impacted by a proposed merger.

Other portions of the Board's proposed regulations should assist the Board in maintaining all competitive rail options post-merger. Proposed Section 1180.7(b)("Market Analysis") requires merger applicants to provide information reflecting "the anticipated effects of the

transaction on...market concentrations," (Section 1180.7(b)(1)), and data indicating "actual and projected market shares of originated and terminated traffic...Applicants should list points where the number of serving railroads would drop from two to one and from three to two, respectively, as a result of the proposed transaction (both before and after applying proposed remedies for competitive harm)." Section 1180.7(b)(2). Unfortunately, the listing of only "two to one" and "three to two" points in Section 1180.7(b)(2) appears inconsistent with the requirement in Section 1180.7(b)(1) that merger applicants demonstrate "specific measures...to preserve existing levels of competition and essential services, and is also inconsistent with Section 1180.1(c)(2), which requires merger applicants to "explain how they would at a minimum preserve competitive options..." (emphasis added).

To clarify the position taken by the Board in its policy statement that the preservation of all competitive rail options is essential in major rail mergers, the Board should require merger applicants to quantify all reductions in rail competition, in all markets, and not limit the disclosure to "two to one" and "three to two" points. Anything short of full disclosure will not further the Board's stated policy of disfavoring "consolidations that reduce the railroad and other transportation alternatives available to shippers."

KCS believes that the changes it has proposed are the manifestation of the first principle referenced above: the preservation of competition. As previously mentioned, the Board has made great strides in its *NPR* toward a true preservation of competition. However, no one can seriously contest that those strides will be challenged, every step of the way, by parties advancing their own agenda through regulatory loopholes and imprecise drafting. KCS's proposed modifications go a long way toward preventing an "end around" of the preservation of competition requirement.

The changes suggested above are not only consistent with the Board's language and the principle of preserving competition, but are supported by numerous other parties. A great number of parties to this proceeding have encouraged the Board to state definitively that major mergers must preserve all existing rail options in order to assure that competition is not harmed.

Making it clear that all pre-merger rail-to-rail options should be preserved is both statutorily sound and feasible. This stands in contrast to the Board's current proposal which allows "enhancements to competition" in one area (even if such an area suffered no adverse competitive harms as a result of the transaction) to offset harm to competition in another area that is directly impacted by the merger. Such an approach is inconsistent with the statute and represents inadequate policy and calls to balance competitive reductions with "enhancements" to competition in other areas thus need to be rejected. The KCS proposal, supported by numerous other commentors, makes it clear that where there is a harm to competition as a result of the transaction, that harm must be remediated.

II. Service Restrictions Contained In Marketing, Haulage And Trackage Rights Agreements Imposed As Merger Conditions Should Be Disclosed And Justified.

In approving mergers in the past, the Board has imposed conditions aimed at ameliorating competitive harm that would result from an unconditioned merger. Some conditions imposed by the Board in past mergers have contained restrictions that limit the full commercial utility of the condition. For example, as a condition to a merger, a carrier may be given access to a given market to compete with the newly merged entity, but the access is limited to a specific commodity or to a specific geographic area. This results in a situation where the carrier is prevented from providing the same range and level of services as the newly merged entity, yet it is supposed to be competing with that newly merged entity.

KCS supports correction of the limitations contained in prior merger conditions where they are no longer consistent with the public interest. Specifically, KCS's proposed that merger applicants be required to include in their opening application filed with the Board: (1) full disclosure of all conditions granted to third parties in prior mergers in which they or their predecessors were involved; (2) an analysis of the continued validity of, or necessity for, any restrictions contained in the prior conditions; and (3) an assessment of whether a condition could be imposed in the current merger to correct the inhibitions to competition resulting from conditions imposed in the prior merger.

Such a proposed rule would be relatively easy to implement in the Board's proposed regulations. For example, in Section 1180.1(d) ("Conditions"), the Board could insert the following language: "The Board will condition the approval of Class I combinations to mitigate or offset harm to the public interest, or to enhance the competitive effect of conditions imposed in prior mergers involving any of the same carriers, and will carefully consider conditions proposed by applicants in this regard." Alternatively, in Section 1180.1(i) (discussed *supra*), the last sentence of subsection (i) could be revised to read "Applicants will be expected to list all conditions imposed in any prior mergers they have undertaken, and to discuss whether those conditions need to be modified to preserve and enhance competition."

KCS believes that the modification it proposes herein is entirely consistent with the Board's stated desire to enhance competition as a remedy to competitive harms resulting from mergers. By reviewing past mergers and identifying opportunities to improve the competitive operation of past conditions, the Board will be adopting a measured, balanced view of the need to enhance competition in the rail industry without approaching, much less embracing, the radical perspective of open access and without resorting to the use of non-remedial competition in one

area in order to "offset" harms in another area. The mandatory review of the scope of past conditions would allow the Board to implement its revised vision of the public interest without specifically reopening prior mergers. Likewise, KCS's proposal would shift the burden of proof over to the party seeking to continue restrictions placed on otherwise viable competition.

KCS's proposal to enhance competition through expanded conditions should not be taken as a license, or even a request, to reopen prior merger decisions. While some may argue that any effort to revisit issues decided in past mergers would be fraught with questions of jurisdiction, particularly after the expiration of any agency-imposed oversight period, KCS's proposal does not suffer from such a constraint. The reason: KCS proposes that the Board revise such prior conditions only in the context of a current merger involving a party upon whom the earlier condition was imposed and only as a condition to approval of a future, as of yet unconsummated, transaction. Thus, the option as to whether to accept changes in prior conditions would rest entirely with merging parties and would simply be a factor to be considered in contemplation whether to consummate the new merger. As such, this modification cannot be deemed inappropriate retroactivity; it is a proactive, forward-looking approach designed to introduce a limited measure of enhanced competition in those select areas where the Board or its predecessor has already determined that a competitive fix was necessary and rests entirely on the notion that the previous conditions must be revised in order to preserve competition in the context of the new merger.

Additionally, and perhaps more fundamentally, the KCS proposal does not require the Board to make any changes to its views on what constitutes an appropriate level of competition, acceptable service, safety, or pricing. Instead, it merely asks the Board to take its existing notions of what constitutes the public interest and apply those notions to previous conditions,

whose beneficial effect upon the previous merger would be undermined by the merger under current consideration.[11] To the extent that such prior conditions remain justified as being in the public interest, they would not be modified. However, to the extent those conditions contain restrictions which are no longer deemed appropriate, the restrictions would be lifted. In essence, this condition merely asks the Board to continue to apply its evolving notion of the public interest to past merger decisions, but only in the context of a future proposed transaction involving one or more of the parties from the previous merger. In other words, the Board should consider what impacts the current merger has on previously imposed conditions. This analysis of so-called "upstream effects" was succinctly put forth in Vice Chairman Burkes comments:

> In addition to looking at possible future "downstream effects," I believe that the applicants should address what impacts, if any, the proposed merger would have on conditions imposed by the Board in previous approved mergers that were employed to enhance or preserve competition, e.g., the shared asset areas established in the Conrail proceeding, the trackage rights BNSF received in the UP/SP merger and other conditions that were established to preserve or enhance competition. In other words, we should also look "upstream" as well as "downstream." I believe that we need to look at the whole picture and not, with blinders on, look just forward.

NPR, at 41.

Vice Chairman Burkes' idea found support from other commentors besides KCS. The National Industrial Transportation League found that "it is entirely possible that a future merger may require a re-examination of past merger conditions, since only such a re-evaluation may

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[11] "We would be remiss if we did not consider today's limits when imposing conditions on a railroad merger instead of viewing the industry as static." *Burlington N. Inc. -- Control and Merger -- St. Louis-San Francisco Rwy.* Co., 360 I.C.C. 788, 950 (1980) (emphasis added) (footnotes omitted). *See also Makita U.S.A., Inc. -- Petition For Declaratory Order – Certain Rates And Practices Of Milne Truck Lines, Inc.*, Docket No. MC-C-30164, 1992 WL 70300 (I.C.C. decided April 8, 1992). ("The volume and complexity of the Interstate Commerce Act combined with the changing nature of the transportation industry render ineffective any static policy.").

uncover a serious loss of, for example, geographic competition."[12] BASF Corporation also agreed with Vice-Chairman Burkes that "The STB should include upstream effects in its deliberations."[13]

Such an idea is not improper retroactive rulemaking. Indeed, one could argue that such a review of upstream effects really represents no change at all, as parties have always traditionally been free to ask the Board to adjust the terms of conditions imposed in prior mergers in order to resolve a competitive concern in the context of an existing merger. While this may be true, KCS's proposal would formalize that process, requiring a review of the terms of old conditions as an element of approving any future mergers. KCS's proposal also would shift both the burden of coming forward, and the burden of proof, onto the parties seeking to merge. KCS believes that the best place to put the description and impact of these previously imposed conditions is in the body of the merger application, where they can be viewed within the context of the overall effects of the proposed merger transaction and its related public interest aspects. If restrictions to competition burdening these earlier-imposed conditions ostensibly remain in the public interest, it should be the burden of those favoring the continuation of those restrictions to demonstrate their worth.

The review of service and other restrictions contained in the conditions attached to prior rail mergers would further the consensus principles earlier explored by KCS. Competition would be preserved through a determination of the impact that the restrictions have on the ability of the restricted party to compete. The merger regulations would be made clearer through a concise

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[12] *Comments on the Notice of Proposed Rulemaking Submitted by The National Industrial Transportation League*, dated November 17, 2000, at 31.

[13] *Comments of BASF Corp.*, at 26.

statement setting forth one particular method by which competition would be enhanced. The alleged benefits of a merger would be reviewed with an eye on the continuing preservation and enhancement of competition through the removal of competition-reducing conditions, and shortlines and regional railroads (which have often been the recipient of conditions with strings attached) would be better equipped to serve the competitive needs of shippers. Because these changes further the four principles guiding this proceeding, the Board should adopt them.

III. Benefits Claimed From Prior Mergers Should Be Preserved.

KCS has long supported the Board's abandonment of the "one case at a time" rule, which the *NPR* now proposes to replace with the new "Cumulative Impacts and Crossover Effects" rule of Section 1180.1(i). The one case at a time rule served only to reduce the breadth of information available to the Board and its predecessor, and to hamper a unified, consolidated vision of the actual interactions and interdependency of railroads. While the conservation of agency resources remains a valid concern, KCS is convinced that the rail industry and, ultimately, the Board, will benefit from the all-encompassing view of rail mergers manifested in the *NPR*.

However, as has been pointed out by many other parties, the open-ended nature of the Board's proposed "Cumulative Impacts and Crossover Effects" rule is likely to generate more heat than light. As currently drafted, the rule does little to separate reasoned analysis and informed prognostication from rank speculation. KCS suspects that opportunists will use the unbridled reigns handed them by the draft regulation to seek conditions that are unrelated to any future merger that has any possibility of success. Moreover, without having any inkling of what competition-enhancing conditions future mergers might bring, few legitimate means exist for

accurately conditioning present mergers. In short, it is possible that the rule, in its proposed form, is unworkable.

KCS believes that two changes are needed to proposed Section 1180.1(i) in order to satisfy the competing goals of adequate information, conservation of resources, and appropriate consideration of other mergers. First, the consideration of other future mergers should be limited to those that have been announced publicly, or for which a prefiling notification has been filed. This change will limit the Board's consideration of the future effect of mergers to those mergers that have some measure of assurance that they will be pursued.

A second change to Section 1180.1(i) is also required to tune the rule more fully to the improvement of the public interest. In reviewing merger applications, the Board should set as a minimum threshold the preservation of benefits conferred (or, at least, claimed) during the course of prior mergers.[14] Any merger that hampers benefits achieved in a previous merger must either be denied outright, or conditioned to preserve the benefits of prior mergers. Compelling merger applicants to justify the impact which their merger will have on the benefits allegedly gained through their past mergers will ensure that the Board's efforts in preserving the public interest will not be mooted by subsequent proceedings. It will also enforce a greater level of accountability on merging partners to see through to completion the touted benefits of their consolidation.

[14] KCS does not mean to limit the scope of "benefit" to those quantifiable "public benefits" relied upon by the Board in evaluating merger transactions. Instead, in the context of the proposed rule, the word "benefits" should mean all of the benefits claimed and relied upon to seek approval of a prior merger, whether or not such benefits qualified as "public benefits," resulting from an imposed condition or a private settlement agreement, or resulting from the nature of the transaction itself.

By adding a focus on the preservation of past merger benefits, the Board would move toward clarifying the intent of the current regulation. No speculation would be introduced into the merger review process, as the benefits associated with prior mergers are a matter of a detailed, examined record, not rank speculation about the potential problems with some potential future merger. Additionally, a greater level of cohesion would be brought to rail service, as service goals and marketing efforts would continue to be given priority.

To effect these changes, KCS proposes to amend the currently proposal as follows:

> Cumulative Impacts and Crossover Effects. Because there are so few remaining Class I carriers and the railroad industry constitutes a network of competing and complementary components, the Board cannot evaluate the merits of a major transaction in isolation – the Board must also consider the cumulative impacts and crossover effects that the current merger is likely to have on benefits conferred or claimed in past mergers, and the impacts and effects likely to occur as rival carriers react to the proposed combination. The Board expects applicants to address all other rail mergers which have been announced, or for which a prefiling notification has been made, ~~anticipate with as much certainty as possible what additional Class I merger applications are likely to be filed in response to their own application~~ and explain how these applications, taken together, could affect the eventual structure of the industry and the public interest. When calculating the likely public benefit that their merger will generate, applicants are to measure these benefits in light of the anticipated downstream mergers. Applicants will be expected to discuss whether and how the type or extent of any conditions imposed on their proposed merger would have to be altered, or any new conditions imposed, following approval by us of any future consolidation(s).

KCS believes that a focus on the preservation of benefits generated by prior mergers is entirely consistent with the four principles shaping the Board's merger regulations. Most importantly, the preservation of past benefits will clearly serve to preserve competition in the railroad industry. As a general matter, the benefits at issue were deemed "benefits" in the context of a prior merger precisely because they had a competitive enhancing effect. Their destruction would clearly decrease competitive options and violate this principle. In addition to adding to the specificity of the merger regulations by bringing into view the impact which the planned

merger will have on prior benefits, KCS anticipates that it will also serve to enhance the interests of shortline and regional carriers, whose shippers have often been positively impacted by the benefits generated from past mergers.

IV. Applicants Should Be Required To Disclose And Discuss The Impact Of Related Negotiated Agreements In Merger Proceedings.

In many recent rail mergers, the applicants have entered into agreements to quell concerns over potential adverse impacts on competition, safety and the environment. In recent years, the Board has encouraged market-based resolutions, and KCS continues to believe that private agreements can often address the legitimate concerns of those opposing mergers while focusing the Board's review on issues genuinely in dispute. No new merger regulation should serve to inhibit the continued use of settlement agreements in merger cases.

Unfortunately, the positive benefits that can be achieved through negotiated settlement agreements are sometimes blurred, or are not fully realized, because current Board policy does not require submission to the Board of settlement agreements in major consolidation proceedings, nor are applicants required to present any analysis or public interest justification for a settlement. In practice, applicants submit only those settlements that they believe are essential to getting Board approval of the transaction. Too often, these agreements are concluded late in the proceeding, up to and including at oral argument. Even if the applicants choose to disclose the terms of the settlement, that information comes too late for analysis of the settlement or of its effects on the public interest.

The failure of the current merger rules to require the disclosure and analysis of negotiated agreements presents a number of unfortunate consequences. Most fundamentally, the Board is left without a complete record of all of the impacts of the proposed transaction. Side agreements,

potentially involving coordinated marketing or operations, are not analyzed by the merger applicants or by the critical eye of affected third parties. If the Board is going to continue to "encourage[] public participation" "to ensure a fully developed record on the effects of the proposed railroad consolidation," as is currently provided for in 49 C.F.R. § 1180.1(h) and will be carried forward at 49 C.F.R. § 1180.1(m), the Board must equip the public with all of the facts relating to the proposed transaction. Finally, the fact that not all merger-related agreements are disclosed might jeopardize the perceived integrity of the merger review process. For all of these reasons, the Board's major merger regulations should require the disclosure of all settlement agreements.

KCS does not believe that its proposal to enhance the record in mergers should raise any concerns over confidentiality. In all mergers in recent memory, the Board has routinely imposed confidentiality agreements that limit the disclosure of select information. Although challenges to the self-selected designations have on occasion been raised, KCS is unaware of any widespread problems with abuse of this well-accepted procedure, and claims of improper disclosure have been virtually non-existent.

KCS believes that the most efficient way to implement the required disclosure of negotiated agreements would be to add a new section to the proposed rules as 49 C.F.R. § 1180.6(b)(14) as follows:

> (i) Applicants have a continuing obligation to file with the Board copies of all settlement agreements as soon as practicable following completion of such agreements. Such agreements may be submitted under any applicable confidentiality provision authorized by the Board, provided at least that outside counsel and consultants for parties shall be able to review the entire agreement.
>
> (ii) Applicants shall submit with the agreement a detailed analysis of the impacts of such agreement on the pending transaction, including projected traffic diversions, projected traffic flows, operating schedules, an implementation plan,

and a full discussion of the environmental, labor, and safety impacts of the agreement.

(iii) Notwithstanding subsections (c)(4), (d)(3) and (e)(3) of this Section, parties to the proceeding shall have a minimum of 30 days to conduct discovery and submit comments and requests for conditions relating to each settlement agreement filed. Should the applicants file a settlement agreement less than 30 days prior to the Board's scheduled voting conference, such submission shall be treated by the Board as a petition by the applicants to modify the procedural schedule to allow 30 days for discovery and comment on the settlement submitted.

(iv) Terms and conditions of settlement agreements shall become part of the record in the Section 11323 transaction and shall, if requested by any party, be subject to modification by the Board or imposition as a condition to the approval of such transaction.[15]

The extension of procedural schedules called for in the draft rule is required to give all parties adequate time to digest the new agreement, undertake some limited discovery to explore all facets of the agreement, and determine what impact the agreement is likely to have on the proposed transaction.

In addition, the disclosure and analysis of settlement agreements complies entirely with the four consensus principles outlined above. In addition to adding specificity to the regulations, KCS's proposal would further the preservation of competition, as adverse impacts on competition that could not be fully comprehended without a knowledge of all relevant agreements will be anticipated and, presumably, accounted for with the Board's conditioning authority. Perhaps most fundamentally, the disclosure of settlement agreements will allow the Board a more complete understanding of the benefits claimed in a merger. Indeed, it is difficult to imagine how the Board can gain a full understanding of merger benefits without informing itself of all of the merging parties' plans.

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[15] See KCS's *Comments on the ANPR*, dated May 16, at 52-53, for a proposed definition of "settlement agreement."

The required disclosure of settlement agreements relating to a proposed merger received significant support in the comment of other parties. For example, Union Pacific stated that the Board "should require applicants to disclose the [settlement] agreements to the Board and participants in the merger proceeding, subject to appropriate confidentiality agreements. The transaction presented for Board approval must include all commitments that are contingent on merger implementation and designed to influence the position taken by a shipper, connecting railroad, or governmental body."[16] Similarly, various associations representing the interests of North Dakota's shippers recognized the need for the "STB...to insure that [settlement] agreements are truly fair to short line and regional carriers and to the shippers and communities that they serve,"[17] a directive that cannot be carried out unless the Board is appraised of the contents of all settlement agreements.

The Board should heed these comments and require all merging applicants to place all merger-related settlement agreements in the docket, subject to appropriate confidentiality conditions. Requiring merger applicants to disclose the side deals they have made to eliminate opposition to their application is crucial to accurate assessment of the true overall effect of a proposed merger. Without such a requirement, the Board's decision on the merger transaction is less than fully informed, and fails to explore the full ramifications of the Board's requested approval. In order to reach farther to preserve and promote competition in a consolidating market, the Board should take the reasonable, moderate step of imposing this proposed rule.

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[16] *Union Pacific's Opening Comments on Proposed Merger Rules,* dated November 17, 2000, at 10.

[17] *Comments of the North Dakota Public Service commission, North Dakota Grain Dealers Ass'n, North Dakota Wheat Comm'n, and North Dakota Barley Council*, dated November 17, 2000, at 4.

V. Recent Cancellations Of Reciprocal Switching Access Should Be Disclosed And Discussed.

As the Board is aware, a number of parties to this proceeding have urged the Board to adopt radical adjustments to the competitive landscape existing in the railroad industry. In particular, some parties have asked the Board to require mandatory reciprocal switching arrangements in terminals (or their Canadian equivalent, "interswitching'), regardless of whether such changes are related to the merger at hand.

As KCS has repeatedly stated in this proceeding, forced open access, even if limited to terminal areas, would have significant adverse impacts on railroads and on shippers in the long run. Such a radical departure from the Board's *Midtec* precedent[18] should be reviewed in the context of a separate *Ex Parte* proceeding. The creation of separate competitive rules in terminal areas (one set for railroads that had undergone a major rail merger after this proceeding, and a separate set for those that had not) would provide a strong disincentive to realize the potential benefits to be had from future rail mergers.

Instead of focusing on mandated reciprocal switching as a condition to a merger proceeding, the public would be better served by focusing on switching issues that have a direct nexus to the merger. For example, under the Board's current merger rules, carriers, which have opened their shippers to reciprocal switching, have an incentive to close those shippers to reciprocal switching before announcing a merger in order to avoid having those shippers treated as shippers suffering a merger related reduction in rail alternatives and, thus, entitled to protection under the Board's conditioning power. Through closing a station to reciprocal

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[18] *Midtec Paper Corp. et al. v. Chicago and N.W. Transp. Co. (Use of Terminal Facilities and Reciprocal Switching Agreement),* 3 I.C.C.2d 171, 173-174 (1986), *aff'd*, 857 F.2d 1487 (D.C. Cir. 1988)

switching prior to a merger, merging railroads might stave off the introduction of a new competitor into a facility or market post-merger.

In order to address the legitimate concerns of shippers which do not receive conditioning consideration because of a recent cancellation of reciprocal switching access, KCS has proposed a rebuttable presumption that all cancellations of reciprocal switching undertaken within two years of the filing of a notice of intent to merge were done with an eye on the merger, and all shippers that suffer a reduction in their access to rail competition as a result of the cancellation are entitled to consideration for competitive impact analysis purposes. The Board has conceded that the cancellation of reciprocal switching rates in response to an anticipated rail merger would be "cause for concern." *CSX Corp. and Norfolk Southern Corp. et al. – Control and Operating leases/Agreements – Conrail Inc. et al.,* Finance Docket No. 33388 (STB served July 23, 1998). KCS's proposed rule is a means by which to resolve that "cause for concern."

KCS's proposal presents a number of advantages: it eliminates most of the potential for gamesmanship with respect to access to shippers; it provides "enhanced competition" in ways that would not be possible outside of the context of a merger; it assures that enhanced competition is brought only to those shippers where such access is feasible (as demonstrated by the fact that the shipper formerly had access to more than one carrier); and it does not invite the sort of adverse impacts surely to result from a general declaration of open access. In order to assure that legitimate business purposes are not swept up in this rule, railroads would be accorded the opportunity to carry the burden of establishing that the presumption that reciprocal switching rates were canceled in anticipation of a merger is incorrect, thus giving the Board flexibility when special circumstances are shown by applicants to overcome the presumption.

KCS's proposed rule preserving the benefits of reciprocal switching could be implemented as new 49 C.F.R. § 1180.6(b)(15)[19]:

> Applicants (including their subsidiaries, whether owned in part or in whole) shall be required to disclose to the Board and any other party all stations, facilities, or terminals served by any applicant that were open to reciprocal switching at any time during the 24-month period prior to the filing of a notice of intent pursuant to 49 C.F.R. § 1180.4(b). For each such station, facility, or terminal that had been open to reciprocal switching during the 24-month period but which is no longer open to such reciprocal switching at the time of the filing of a notice of intent pursuant to 49 C.F.R. § 1180.4(b), a rebuttable presumption will be created that favors the reinstatement of the reciprocal switching. Upon request of any party, the Board shall require applicants to reopen all such stations, facilities, or terminals to reciprocal switching as a condition for approval of any merger or control transaction. Applicants may overcome the rebuttable presumption only upon a showing that there is substantial public interest in keeping the facility, station, or terminal closed to reciprocal switching upon approval of the merger.

Reviewing recent cancellations of reciprocal switching arrangements is entirely consistent with the four consensus principles that most parties support. As such cancellations were presumptively taken in anticipation of a merger, a review of such situations will aid the Board in assessing the real benefits of the proposed transaction. Additionally, if the Board is actually to preserve competition, then it must not allow competition to be reduced before a merger through artificially closing shippers to reciprocal switching. Instead, the Board must preserve not just the competition to be harmed in the future by the combination, but must also preserve all competition that was hampered in anticipation of the merger.

KCS believes that the rule it has proposed strikes the appropriate balance between parties desiring to open all facilities through open access and parties working for the status quo. While few parties have specifically addressed the proposal as framed by KCS, the Port of Pascagula has brought before the Board the problems it experiences in competing with other ports when

[19] See Section IV. For proposed new 49 C.F.R. § 1180.6(b)(14).

railroads, through such means as opening or closing the port to reciprocal switching, can "have the practical effect of favoring one port over its competitors," which has "a devastating impact on a port's ability to compete with others for cargo."[20] These comments, coupled with the Board's own experience with the possible ramifications of merger-induced cancellations of reciprocal switching rights, should be more than enough support for the Board's adoption of KCS's proposed solution.

VI. The Definition Of "Major" Merger Transactions Should Be Limited To Mergers Involving Only The Largest Railroads

As detailed in *KCS' Comments on the ANPR*, the Board and its predecessor have not treated all proposed railroad mergers identically, but rather have categorized such mergers according to the types of entities merging, and the scope of the transaction. These categories have been modified several times over the past twenty years, in order to accommodate the changing nature of the nation's railroads. KCS believes that it is time to modify the categories once again, to assist in preserving the competitive options provided by the nation's regional freight railroads. Specifically, KCS has proposed that mergers involving two or more Class I carriers be treated as a "significant" and not a "major" transaction to the extent that at least one of the Class I carriers has annual operating revenues of less than $1 billion in the previous calendar year, unless the merger is being effected against the corporate will of the smaller Class I carrier, in which case the merger would be treated as a "major" transaction. Such a modification to the existing classifications would more appropriately reflect the current disparity among Class

[20] *Comments of the Port of Pascagula, Jackson County Port Authority*, dated November 17, 2000, at 7.

I carriers, would better protect the public interest, and would further the Board's directive to minimize regulation of the rail industry.

The disparity between large and small Class I railroads is perhaps best demonstrated through the following chart of the annual revenues for the nation's Class I carriers:

Union Pacific Railroad	$ 10.2 billion
The Burlington Northern and Santa Fe Railway	$ 9.1 billion
CSX Transportation, Inc.	$ 5.6 billion
Norfolk Southern Corporation	$ 5.2 billion
Canadian National Railway (including Illinois Central)	$ 3.5 billion
Canadian Pacific Railway	$ 2.4 billion
The Kansas City Southern Railway Company	$ .5 billion

A similar disparity is evident from a review of total track miles operated by the Class I's:

Union Pacific Railroad	33,705
The Burlington Northern and Santa Fe Railway	33,500
CSX Transportation, Inc.	23,400
Norfolk Southern Corporation	21,800
Canadian National Railway (including Illinois Central)	15,777
Canadian Pacific Railway	14,358
The Kansas City Southern Railway Company	2,756

The importance of the Board's adoption of KCS's proposal has taken on added significance since it was first proposed by KCS in its *Comments on the ANPR* of May 16, 2000. On September 25, 2000, the Board opened *Consolidated Railroad Reporting*, Ex Parte No. 634 (STB served September 25, 2000), under which the Board proposes to adopt Financial Accounting Standards Board Statement No. 94, *Consolidation of All Majority-owned Subsidiaries* (1987) ("FASB 94"), which would require that railroads consolidate the reporting of financial information for all majority-owned and controlled subsidiaries. Adoption of FASB 94 by the Board would accelerate the move of larger Class II carriers move into the Class I rank, and would greatly increase the number of potential "major" mergers under the Board's merger regulations.

Regardless of whether the Board ultimately adopts FASB 94, however, KCS and several large Class II carriers, including Wisconsin Central Ltd. ("WCL"), Montana Rail Link ("MRL"), and Florida East Coast Railway Company ("FEC"), all share a common trait: while filling important roles in the markets they serve, they do not possess the market reach of the six largest Class I railroads. Due to the limited geographic scope of regional carriers, a merger of one of them into one of the largest Class I railroads would not raise the competitive issues, nor require the same depth of review, as should properly be accorded to a merger of the two of the Class I giants. However, because these regional carriers have sufficient size to compete (on a limited basis, in select markets) with the mega-Class I carriers, it is critical that any attempt to control them against their will must be met with the highest level of scrutiny, to ensure that competition, safety, and service do not suffer.

In order to meet these vital concerns for North America's much smaller Class I carriers, KCS proposes to modify the Board's merger regulations to allow the smaller Class I's this treatment, in order to promote the public interest.

Amendment of the Board's merger regulations to accommodate KCS's proposed change would be quite simple. The caption for 49 C.F.R. § 1180.1 would be changed from "General Policy Statement For Merger Or Control of At Least Two Class I Railroads" to "General Policy Statement For Major Transactions As Defined In 49 C.F.R. § 1180.2(a)." In turn, 49 C.F.R. § 1180.2 ("Types of Transactions") would be amended to read:

> Transactions proposed under 49 U.S.C. § 11323 involving more than one common carrier by railroad are of four types: *Major*, *significant*, *minor*, and *exempt*.
>
> (a) A *major* transaction is a control or merger involving two or more class I railroads where at least one of the railroads involved in the transaction had gross U.S. railroad operating revenues of $1 billion in the last calendar year. However, in the event a control or merger transaction involves only two Class I railroads or two

> Class I railroads and one or more Class II railroads and one of the Class I railroads involved in the merger or control has gross U.S. railroad operating revenues of less than $1 billion in the last calendar year, the transaction shall be treated as a significant transaction, and is exempt from the application of 49 U.S.C. § 11324(b) (but is subject to 49 U.S.C. § 11324(d)) pursuant to the authority of 49 U.S.C. § 10502, unless such Class I railroad objects to the proposed merger or control, in which case the merger or control shall be treated as a major transaction.
>
> (b) A *significant* transaction is a transaction that is not a major transaction but that is of regional or national transportation significance as that phrase is used in 49 U.S.C. § 11325(a)(2) and (c). A transaction which is not a major transaction is also not significant if a determination can be made either:
>
> > (1) That the transaction clearly will not have any anticompetitive effects, or
> >
> > (2) That any anticompetitive effects of the transaction will clearly be outweighed by the transaction's anticipated contribution to the public interest in meeting significant transportation needs.
>
> A transaction which is not a major transaction is also not significant if neither such determination can clearly be made.

Unfortunately, the revised merger regulations proposed by the Board in the *NPR* do not reflect these proposed changes, and other than summarizing KCS's comments on this point, the Board does not address the merits of this proposal in its *NPR*. Frankly, KCS had fully anticipated that the Board would embrace this proposal, particularly given certain comments recently made by the Board to the effect that there are "only six large railroads remain[ing] in the United States and Canada."[21] The Board's candor in recognizing that all Class I railroads are not created equal deserves recognition in its merger regulations.

KCS's proposed treatment of the much smaller Class I railroads involved in mergers would further the principles enunciated earlier in these Reply Comments. Specifically, the

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[21] *Public Views On Major Rail Consolidations*, Ex Parte No. 582, at 1 (STB served March 17, 2000).

interests of regional railroads, such as KCS and other railroads which might soon advance to Class I status, would be furthered through a reassessment of the information needed to adequately review a merger of one of those railroads with a large Class I carrier. In addition, allowing the smaller Class I carrier to elect to have the merger treated as a "major" merger would also protect regional railroad interests.

The adjustment to the classification of a "major" transaction has the support of several parties to this proceeding. Specifically, Wisconsin Central Ltd. ("WC") commented:[22]

> [N]one of these mega-merger considerations necessarily or even probably applies to transactions involving smaller Class I's or larger Class II's that could eventually become Class I's. A proposal by a large Class I to acquire WC, for example, neither has nationwide implications nor sets up any apparent 'responsive' merger by any other carriers. It is simply a regional transaction that increases the feeder lines attached to the larger Class I. It neither changes the character of the larger Class I nor alters the competitive landscape of the national rail system as a whole...new rules designed to govern mergers among the 'Big Six' do not apply comfortably to transactions between a large Class I and a smaller Class I...

To similar effect, the United States Department of Transportation ("DOT") noted that "not every possible combination of existing or prospective Class I railroads will necessarily introduce the same qualitative and quantitative risks that a transnational merger of domestic or international carriers would. DOT thus urges the Board to consider that there may be instances in which the height of the 'bar' could be adjusted without harm to the public interest."[23]

VII. Merger Applicants Should Be Required To Disclose And Discuss Paper And Steel Barriers Applicable To Their Shortline Interchange Connections.

Shortline railroads are vital to the continued operation of the nation's light density rail lines. The service these smaller railroads provide, particularly to small communities, is crucial to

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[22] *Opening Comments of Wisconsin Central System*, dated November 16, 2000, at 9.

[23] *Comments of the United States Department of Transportation*, dated November 17, 2000, at 2.

the economy of many rural areas. Yet, these railroads' ability to provide cost-effective service is being endangered by continued Class I consolidation, by limits placed on their access to additional sources of revenue, and by increased demands for new infrastructure investment to handle larger cars and trains. While the creation of paper and steel barriers has not generally been related to major rail mergers, the occurrence of future mergers provides the opportunity for the Board to enhance competition by freeing shortlines connected to the merging carriers from these hindrances to competition.

KCS has not proposed that all paper and steel barriers be removed from every shortline connecting to every merging Class I carrier. Such a rule would paint with far too broad a brush. Instead, KCS has proposed that in all major mergers, the applicants disclose the existence of all paper and steel barriers in their merger application. KCS's rule is thus a "disclosure" rule and not a regulatory requirement. It would then fall on the Board to determine whether the identified barriers are consistent with the public interest, or should be removed to improve shipper service, competitive options in terminals, etc. The key to the proposal is the provision of information to the Board, which is essential if the Board is to make the requisite findings. Requiring the disclosure of paper and steel barriers and then allowing the Board to remove or modify those barriers that are inconsistent with the public interest, in the context of a major merger, would ensure a complete evaluation of the public benefits and harms of a proposed transaction.

In order to implement KCS's proposed mandatory review of paper and steel barriers, the Board should clarify that the requirement of Section 1180.7(b)(6) to include a disclosure of, and

justification for, all existing paper and steel barriers currently impacting operation of those links.[24] That section of the merger regulations would then read as follows:

* * * * *

> Applicants impact analysis must at least provide the following types of information:
>
> * * * * *
>
> (6) A list of all provisions of any agreement between any applicant and any Class II or Class III carrier (including a Class II or III carrier owned wholly or in part by an applicant) having a direct physical connection to one of the applicants which agreement in any way limits the ability of such Class II or Class III carrier to interchange or connect with any non-applicant carrier, along with an explicit delineation of the projected impacts of the transaction on the ability of various network links (including Class II and Class III rail carriers and ports) to participate in the competitive process and so sustain essential services. For each such listed provision, applicants shall discuss the underlying rationale for such a provision and explain how the transaction will impact the operation of the provision. Applicants shall further discuss whether the provision should be removed, and analyze how removal of the provision would impact the proposed transaction. Upon request of any party, the Board will review such provisions and determine whether the public interest requires modifying or eliminating that provision to facilitate the ability of such a Class II or Class III carrier to interchange with, connect with, or otherwise conduct business with any other carrier.

Proposed 49 C.F.R. § 1180.7(b)(6), as amended.

The Board has already taken the logical step of indicating that the impacts on smaller carriers and ports need to be reviewed in a major merger. It is now time to flesh out that statement by putting all interested parties on the same informational footing. The impact of a merger on smaller carriers cannot be assessed accurately if all of the relevant restrictions on that carrier's operations are not fully disclosed. In addition, disclosure of all paper and steel barriers

[24] While the Board references the removal of paper and steel barriers in the comments relating to 49 C.F.R. § 1180.1(c), it does so in the context of listing potential means of preserving and enhancing railroad competition. While laudable in purpose, the problem with this handling is that it leaves consideration of paper and steel barriers entirely in the hands of the merging applicants. KCS's proposed revision to the regulation would explicitly require consideration of paper and steel barriers, without compelling applicants to adjust those terms in the first instance.

will assist the Board in determining what competition-enhancing conditions it might need to prescribe in order to ensure that the transaction furthers the public interest.

The consideration of the merits of paper and steel barriers would assist in furthering the four consensus principles that guide this rulemaking. Undoubtedly, the focus on paper and steel barriers will add to the level of specificity of direction contained in the rules. Just as assuredly, consideration of the role played by contractual and physical restrictions will help to preserve competition by identifying markets and service territories where railroads can "fill the gap" left by merging carriers. The Board will gain a greater understanding of the benefits attainable in a merger, and if shortline and regional railroads will benefit the most from the removal of restrictions which currently prevent them from fully utilizing their facilities to provide shippers with competitive options.

The comments filed by various parties in this proceeding demonstrate a strong support for some consideration during the merger review process of the impact which paper and steel barriers have on smaller carriers. However, the comments do not reflect any consensus for handling paper barriers. Some parties favor their immediate removal as a condition to receiving merger authority.[25] Other parties would create a rebuttable presumption calling for the removal of paper and steel barriers,[26] while others urge that caution in the removal of any barrier that was put in place as a result of negotiations conducted during a line sale.[27] KCS believes that the best

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[25] *Comments of Ameren Services Company*, dated November 15, 2000, at 3; *Verified Comments of Farmrail System, Inc.*, dated November 17, 2000, at 7

[26] *Comments of the State of New York in Response to Notice of Proposed Rulemaking*, dated November 17, 2000, at 16

[27] *Comments of the Rail Labor Division, Transportation Trades Department, AFL-CIO in Response to Notice of Proposed Rulemaking*, dated November 17, 2000, at 6.

approach to handling paper and steel barriers would be a pragmatic, case-by-case inquiry into the merits of each restriction. At bottom, however, such a case-by-case inquiry cannot rationally be undertaken unless the disclosure proposed by KCS is made a part of the Board's regulations.

Conclusion

As the Board is fully aware, the comments submitted by over eighty parties clearly indicated a great diversity of views. Despite this diversity, it is possible to develop four "consensus principles" that are supported by almost every party:

1. The merger rules must preserve competition.
2. The merger rules must be made more specific.
3. The merger rules must provide closer scrutiny of claimed benefits.
4. The merger rules must protect shortline and regional railroad interests.

These four principles represent the collective vision of the parties participating in this proceeding. The principles should be viewed as a minimum, or baseline, against which all merger regulations must be measured, and against which all merger applications must ultimately be measured. Compliance with these principles will go a long way toward improving the overall satisfaction of all parties (large and small railroads, shippers, labor, ports and governmental interests) with the merger review process.

The seven proposals suggested by KCS would further these four principles. Through implementation of KCS's seven modest modifications to the regulations, the Board will not only further these principles, but will also achieve a middle ground between those who would reregulate the rail industry and those who recommend few substantial changes to the current regulations.

As these reply comments show, KCS's is not alone in its view. Many of the commentors specifically endorsed KCS's proposals and have urged the Board to adopt changes to the existing regulations that are entirely consistent with KCS's proposed changes. The Board should heed these calls, seek consensus, and adopt the seven proposals set forth by KCS.

Respectfully submitted,

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